

OUR ATTITUDE TOWARDS PAY POLICY

A Paper by Geoffrey Howe

1. I suggest four key questions on which we need to present a coherent attitude:

A. Is the choice, this year and hereafter, simply between "incomes policy" and "free collective bargaining"?

B. Whatever our attitude to (A), does the mastery of inflation require some kind of relationship with the unions?

C. Does such a relationship imply anything in the way of a pay deal or pay policy?

D. Does the right approach depend on, or might it be favoured by, the maintenance or creation of any institutions or other institutional change?

The answers depend in some measure on the present and future economic situation.

The Outlook

2. Any policy aimed at lowering the going rate of pay settlements is, and will remain, under acute economic pressure, because of the inevitability of some further decline in average living standards - which can only mean that incomes before tax should grow substantially less quickly than prices. As we know, the sacrifices so far have largely been borne by the unemployed and by those whose differentials have been compressed. Lower income groups and those in the public sector, who have done relatively well in recent years have still to accept their share of sacrifice. They will not do so with good grace. Yet what is now probable (and indeed necessary) is a reversal of the income redistribution of recent years.
3. This will not be made any easier by the re-acceleration of price increases, perhaps to an annual rate not far short of 20% nor by the fact that Stages I and II have required increases in pay to be made as supplements to the wage structure rather than being carried through into overtime pay, piece rates and so on. The pressure to "consolidate" the supplements is getting stronger all the time. Consolidation alone could add 5% or more to manual earnings; and it would aggravate the problem of differentials still further, since there is no analogous process for the typical salary earner.
4. There will be other difficulties. Commodity prices have been rising sharply. Food prices are likely to go up abruptly as subsidies are withdrawn, and our transition to EEC food price levels continues. The outlook for the exchange rate is uncertain. Cash limits have still to be effectively applied to the nationalised industries, so that unions there are behind their colleagues in other parts of the public sector, who have at least begun to appreciate how they work. Finally, very serious damage has been done in the last four or five years to the conventions and standard procedures of collective bargaining, which means more instability. This

will be increased by the clear resurgence of militancy on the shop-floor, some of it spontaneous, some of it orchestrated by the extreme left.

5. Considered in isolation, all these pressures, to release the spring compressed by incomes policy (and to challenge the facts of economic life) could well overcome any hopes for income restraint. On this basis, there are two possible paths that earnings might follow:

a) If people bargain for "last year's RPI" (15% or so), plus something for consolidation, productivity deals and restructuring (5% say) then the average earnings could increase by up to 20%.

b) If there was a straight repetition of 1974, one could get a jump in the level of settlements of about 15% p.a., which could take the overall rate of earnings increase to nearly 30% p.a.: the much talked of "wages explosion".

6. Standing in opposition to a resurgence in wage claims are:

- a policy of monetary restraint dictated by the IMF.
- the high and growing level of unemployment;
- the (outside) possibility of a faster rate of economic growth than currently assumed with greater scope for growing consumer spending.

7. There is little chance of a major recovery in economic expansion in other countries or, a fortiori, in the UK. All the signs are that the next two years will see international growth at best in line with historical trends and a feebler performance in the UK.

8. The deterrent effect even of present unemployment levels is, I fear, still not proven. Can we be sure that they would, unsupported, exercise a serious restraining influence in time to choke off an explosive outburst?

9. The effects of the IMF imposed monetary targets are also uncertain. For a start, we do not yet know (for a variety of technical reasons) quite how tight a restraint they will impose. However, they should influence wage bargaining in two ways:

- first, by making it impossible to finance inflationary wage awards, thus leading in due course to higher unemployment;
- second, by creating a climate of more modest expectations for future wage and price increases.

This somewhat intangible psychological process can in turn come about through a process of conditioning, of which Britain (unlike some countries) has had too little, since the targets are so new; through being spelt out in cash limits, a process which has not yet reached all the public sector, let alone the lame ducks; and/or through a process of education and explanation, aimed at union leaders and opinion formers, such as takes place formally in Germany or informally in the USA. We cannot by any means be sure that this has yet been taken far enough in the UK to have had a profound and lasting effect

throughout the labour force. (All the recent emphasis on incomes policy will have had an opposite effect)

10. This gloomy analysis does not, of course, mean that a wages explosion could or would carry on indefinitely and unchecked. But it does suggest the grave danger of a collision between sharply rising wages and monetary restraint, which could be highly disruptive to national life and very costly in terms of unemployment and damage to profits, investment and growth.

The Essentials of Policy - For Any Government

11. Even those who believe that a near-permanent, institution-alised incomes policy is in general desirable, can hardly claim that this is a good year in which to introduce it. The severe distortions and pressures in the labour market can only work themselves out in less tightly controlled conditions and, for the most part, through the collective bargaining process, warts and all. Some acceleration in wage increases and increase in unemployment will probably be the by-product of this process, however skilfully it may be handled: a deplorable state of affairs, but nonetheless inevitable for that. Any fresh, centralised and dirigiste solution, coming after two years of rigidity, would surely provoke a ferocious and uncontrollable response. Even the present policy is already threatening to do just that.
12. So the immediate response must involve a much freer approach. But should this mean a "return to free collective bargaining"? Some of the necessary features are clear:
- a) extension of the cash limits system as far as possible throughout the public sector, probably with some redefinition to make the limits bite more specifically on wage and salary costs than they do now;
  - b) a tightening up of the financial regimes applied to the nationalised sector and the lame ducks, particularly the strategic ones such as Leyland, and also the NEB;
  - c) an improvement in the methods of determination of public sector wage, salary and pension levels. This must involve a relative reduction in those parts of public sector remuneration that cause resentment or tend to push up private pay levels through the competitive process;
  - d) urgent repair and improvement of the collective bargaining framework and the rest of the labour market both to prevent a repetition of 1974 in 1977, and to make possible an orderly return to freer bargaining;
  - e) clear and well publicised explanation by the Government of the severe and inescapable limits imposed by the IMF (and subsequent) rules for money supply - with wider implications for cost, jobs and so on.

That is close to the position we advocated in "The Right Approach".

What More is Needed?

13. Is this likely to suffice? I am doubtful whether this position would be adequate in a number of situations which we could face if there were an election in the reasonably near

.. / future; certainly

future; certainly a number of our supporters take this view. For example:

a) Suppose we were elected in course of an apparently operative stage III (in which the guidelines were, deliberately, very lax) could we or should we explicitly abandon them either of our own accord or in response to pressure from the TUC? Or would this be regarded as provocative by the IMF, imprudent by our overseas creditors and alarming by employers at home - if only for the reason that to deliberately abandon a policy for restraint would appear perilously like an invitation to unions to claim what they like?

b) Perhaps more probably, suppose that we inherit a rather tattered policy hovering on the verge of death in face of a serious upward surge of wage costs? Once again we should be under pressure from industry (both public and private), the IMF and public opinion, all pleading for some kind of policy to be kept in being. Both examples suggest that we cannot rigidly insist on pursuing an uncompromising policy of free collective bargaining because of the circumstances in which we might come to office. It could well both look and be silly.

c) More immediately, what attitude should we adopt towards attempts by the government to construct some kind of Stage III?

14. The question is whether it is sufficient to respond to all these possibilities by asserting, beyond what is said in paragraph 13, simply our commitment to return to "free collective bargaining". Or should we do better to accept that, even as set out in paragraph 12, our position does, of course, imply a policy for earnings of a kind, as well as the need to secure its acceptance.

15. Money supply targets for the economy as a whole and cash limits for the public sector, imply clear limits to the growth of wages which can be reconciled with our other economic objectives. Thus we clearly mean to influence the level of pay settlements, even if not directly. Moreover, even if Government has no overall targets or even a conscious strategy for pay settlements, the decisions it takes as employer help to define a policy of a kind, simply by the accumulation of precedent.

16. Though we may be able to refine and strengthen the system of cash limits sufficiently to reduce the risk that major unions will undermine the limits, aggressive union or employee behaviour may still seem to challenge the money supply and cash limit constraint. And people fear this process of challenge, regardless of the outcome. If the limits are adhered to, but at the cost of long, painful strikes, the government could be in nearly as much trouble as it would be by yielding to force majeure, by relaxing the money supply (and cash limits) to finance excessive wage increases. Can we therefore be sure that we need nothing else, beyond credible autonomy, confidence and leadership to secure the greatest possible acceptance of the need for cash restraint and for voluntarily responsible behaviour?

#### Securing Acceptance

17. It is tempting to see the business of "securing acceptance" as a process which will proceed automatically as economic

.. / realities make

realities make themselves felt in millions of minds up and down the country. But can the process be left entirely to the working of a properly informed labour market? Is there not perhaps a crucial link in the process of securing acceptance to be found in the minds of union leaders and their advisors? The union leadership is, of course, never omnipotent nor even united, but is there not a great underlying sense of loyalty to the movement, such that what the leadership recommends or decides can guide policy in the short run and tell people what to think or believe or accept in the longer run? Clearly no government could wish to have such a powerful influence pitted against its entire economic policy.

18. How then to ensure the greatest acceptance of our policies and of economic reality? The first point is one of psychology. After the events of recent years, the union leadership are still suspicious of our intentions. They fear what they believe to be our basic objectives, suspect our economic analysis and are still offended at the breakdown of communications between Conservative leaders and themselves which was at one time in many respects easier than with the Labour leadership. Can psychological barriers of this kind be broken down except by human contact?
19. The second difficulty is that individuals may be incapable or unwilling to initiate actions on their own to do things which they will all admit are in their collective interests. How is it in any one union leader's interest to commend or enforce responsible behaviour in his own union if he fears that other unions may seize the opportunity thus created to further their own interests? Does someone not have to act, in however loose a manner, to bring the major protagonists together and to induce them to behave more in terms of their collective rather than their individual interests? The TUC is still unlikely to do such a thing without some prompting. Does not government have a role in this respect?
20. The third problem is ignorance, or reluctance to admit openly, economic truths which people may recognise secretly in their hearts. It has taken the union leadership and shop stewards an extraordinarily long time to recognise (even as far as they do) that there is a link between rising pay, rising prices and rising unemployment. Any belief even in this causal link is still capable of being suspended for quite long periods of time if it suits the self-interest of any one group. There is even less appreciation of the link between a system of monetary targets and differing rates of increase of pay and levels of unemployment. Perhaps even more important: can we be sure that union leaders will be convinced of a government's commitment to a more rigid monetary policy than in the past unless every opportunity is taken to spell that out to them.
21. All these reasons suggest that we have to have some kind of relationship that goes beyond an arms length assertion of our desire to return to "free collective bargaining".

#### The Wrong Kind of Relationship

22. By now we have had ample experience to set out certain things which such a relationship should not be. It should not be part of a policy of political appeasement or of a willingness to appease if necessary. We are not seeking to continue to sell the nation's birth-right for ever more dubious messes of pottage. It does not mean that Government can be expected to do things which the nation does not want,

.. / such as introducing



such as introducing Bullock and the Wealth Tax, so that unions are bribed year after year to do what is both in their own and in the national interest anyway. It cannot be in any sense an exclusive relationship. It cannot mean that Conservative leaders will get involved in an essentially secret dialogue with the TUC which inevitably smacks of such dealing. We want not a deal but understanding, from union leaders - as well as from their members as well as the rest of the community.

The Right Kind of Relationship

23. This should be based on the kinds of issue set out in paragraph 12 and elsewhere:

- spelling out inflation and monetary targets, and their implications for earnings
- developing as part of this process an acceptance of the case for a much lower general trend of wages, thus dampening expectations about both wage and price trends
- seeking honestly ways of increasing flexibility of bargaining and relaxing the tensions in the system which can be implemented in response to unions acceptance of their responsibility being exercised. (This should include pursuit of labour market reforms).
- discussing with the unions - as with other interests - what policies are needed to "get the economy right"
- always in the background, and at some periods in the foreground, would be the special measures to be taken to improve bargaining in the public sector.

*Output*

In essence one would be offering unions as much freedom as possible, in exchange for their exercising those freedoms in a responsible manner.

24. Very tentatively, I incline to the view that we should be unwise to exclude the possibility of such discussion leading to some agreement on a desirable maximum figure for the general level of pay settlements. This has not been excluded from the agenda of Germany's concerted action; but it is not regarded as disastrous, or anything like it, if agreement cannot be reached. This may be the best basis on which to approach Stage III.

*Old  
From  
File  
Review  
Agreed  
Amended*

Any New Institutions?

25. The arguments for new procedures or institutions are strongest in the public sector. There might be need for some procedure which deals with any kind of claim to exceed cash limits in a particular sector (for example the police). This might be able to secure that any excessive wage claim in one part of the bureaucracy. This could create useful antipathy towards those groups pressing for excessive pay or employment. Clearly some kind of procedures are required to deal with central and local government pay. They will almost inevitably have to deal with the problems of just relativities sooner or later. However, impossible it may be to establish objective criteria on which relativities can be set, no employer can avoid having to take decisions about them. Some kind of agency might have a role to play here.

26. As we stated in The Right Approach it is probably worthwhile developing, on the basis of NEDC, some more widely representative equivalent of the German concerted action approach. I shall shortly be bringing forward another paper from Economic Reconstruction Group, which has been working on this proposal.

Price Control

27. I am sure we must work towards the dismantling of the present regime for price and profit control - while remaining ready to extend the role of the Monopolies Commission and competition policy. But there is no case for being publically committed to this. James Prior believes, as I understand him, that it might still be prudent to preserve some kind of Price Commission (and the skeleton of a Price Code) which can be deployed in a pay "emergency" in the near future. It is argued that the price/pay enforcement system operated by the present government is a subtle and effective one which we should be unwise to discard immediately. I am not so sure of this.

G.H.